Making the most of your TFSA contribution

Answering some common TFSA-related questions

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By Kim Inglis

Canadians are becoming more aware of tax-free savings accounts (TFSAs) but still have many questions about how they work and how best to maximize them.

Basically, Canadians 18 years or older can currently save up to $5,500 a year tax-free, with no maximum age limit on contributing. Unused contribution room can be carried forward indefinitely. The extensive list of eligible investments generally includes money market, stocks, bonds, ETFs and funds. Investors can make withdrawals at any time in any amount without being taxed, and re-contribute the full amount not earlier than January 1st of the following year, when it is added to contribution room.

It's important to remember that re-contributions in the same calendar year as the withdrawal count against contribution room and could cause over-contributing, which the Canada Revenue Agency penalizes. The good news is that CRA keeps track of contributions made in previous years, so an investor who is not certain where they stand can contact the CRA to be certain.

Contribution limits have changed considerably over the years, so there may be confusion about the amount an individual can contribute. An investor who has never contributed to a TFSA, but has been eligible since 2009, can invest up to $52,000 in 2017. For those who have been maximizing their contributions yearly, the 2017 limit is $5,500.

One remarkable aspect of TFSAs is that investors of all ages can benefit from them. Young people, in lower income tax brackets when RRSP refunds are less advantageous, have an alternate vehicle to increase their savings tax-free. The funds are also accessible in case of emergency. Wealthy investors, who are likely to have maximized their RRSP contributions, are provided another route to tax-sheltered growth. Seniors can benefit because, unlike RRSPs, a withdrawal from a TFSA is not considered income and therefore doesn't affect eligibility for Old Age Security.

A common question is whether investors should contribute to their RRSP, TFSA, or both. In an ideal world, they would contribute to both. For instance, they could contribute to their RRSP and then use the tax refund to contribute to their TFSA. If investors have to choose one over the other, they should consider their marginal tax rate. If it is expected to be lower in retirement, they may be better off opting for RRSPs to take advantage of the deductions during higher earning years.

Finally, the most often asked question regards TFSA holdings. Generally speaking, investors get the most out of TFSAs when they use them to grow assets. Sadly, some people believe their TFSAs (Tax-Free "Savings Accounts") are the same as any other "savings accounts" and use them to hold cash. This is a very inefficient use of TFSAs. Consider an investor who contributed $5,500 to a TFSA, fully invested in an exchange-traded fund earning 10% for the year. They would have a tax-free profit of $550. The investor who

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left the contribution in cash generating 1.50% only received $82.50. The difference speaks for itself.

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